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SIPDIS

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TAGS: ECON EMIN EINV ETRD BL
SUBJECT: BOLIVIA: MINING PROBLEMS IMPACT GOVERNMENT

Classified By: EcoPol Chief Mike Hammer for reasons 1.4 b,d

¶1. (SBU) Summary: Mining woes caused in part by the recent fall in world mineral prices are making front-page headlines in Bolivia, and the government has announced the first of potentially many "loan funds" for the cooperative mining sector. Further state involvement in the economy is not a surprise from the ruling Movement Toward Socialism (MAS) party, but these interventions have a clear political edge: cooperative miners are one of President Evo Morales' most militant street-protest groups. Evo is also possibly responding to pressure from his cocalero allies (his other reliable street-fighting force) to keep unemployed miners from entering into the coca business (many cocaleros are former miners who left mining during the industry-wide collapse in the 1980s). The Bolivian state is also hurt by the fall in mineral prices because of its direct involvement in the mining industry: the state's newly-nationalized Huanuni mine is now suffering from excess production and too many under-employed state miners.

¶2. (C) Summary continued: The government's coffers will be indirectly affected by lower tax income from large international mines (such as Apex's San Cristobal and Coeur's San Bartolome) and from closures (such as Newmont's Inti Raymi gold mines, scheduled to close in 2009.) There are also indications that the government's much-hyped international joint-ventures may slow or stop: Korean state mining company Kores's involvement in the CoroCoro copper project is only at the exploration stage, as is Jindal's investment in the Mutun iron deposit. Many observers now question whether Jindal will fulfill its earlier promises of USD 1.2 billion in investment, or whether it will instead strip-mine the enriched surface ore and then leave the country, using the government's inevitable inability to provide promised infrastructure and gas as an excuse to break the contract. Industry analysts are bemoaning the fact that, thanks to government policies, Bolivia lost the chance to attract

international investors during the preceding years' mineral boom. End summary.

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Keeping Cooperativists Cooperative
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¶3. (SBU) The steep fall in minerals prices has hit Bolivian cooperative miners hard. Press reports are full of stories about luxury Hummer vehicles on sale in Potosi and thousands of "peons" (day laborers employed by the cooperatives' partners) returning to the countryside as work dries up in the mining centers. Press reports suggest that 80 percent of the cooperatives in Potosi have stopped operations, while in Oruro three cooperatives (with over three hundred partners and uncounted day laborers) have shut down.

¶4. (SBU) Because of their status as "social organizations", mining cooperatives pay almost no taxes, and therefore the sector's plight is not a direct risk to the government's coffers. Cooperative miners are one of President Evo Morales' support bases, however, and as such they must be appeased. Cooperative miners were present at the "vigil" around congress on October 21, and reportedly Evo had to personally restrain the head of the national cooperative federation FENCOMIN from dynamiting the gates of Congress to "encourage" the opposition to speedily resolve negotiations. Although a oft-used ally, the cooperative federation FENCOMIN is not automatically on the side of the MAS, and in previous standoffs FENCOMIN has wrested considerable concessions from the government in exchange for peace or for their participation in pro-Evo protests.

¶5. (SBU) On October 23 the government announced, in conjunction with the leadership of FENCOMIN, that a government fund would be created to support cooperative zinc mining during economic downturns. The USD 5 million tax-supported fund will operate by subsidizing cooperative miners during times of low zinc prices; in exchange, the cooperatives will be expected to pay back into the fund when prices rise. Specifically, when zinc prices drop below 65 cents per pound cooperatives will be able to claim subsidies from the government in the amount of the difference between the market price and 65 cents (with a maximum of 20 cents per pound subsidy), while cooperatives will then be expected to pay back the subsidies into the fund when the prices rise about 65 cents per pound (at a rate of ten percent of the difference between the higher price and the 65 cent "baseline.")

¶6. (SBU) The potential for fraud under this system is substantial, taking into consideration the flexible nature of cooperatives and the complete lack of any government oversight in the sector. The government also seems to have accepted a bad deal in terms of the payback structure: at prices of 45 cents per pound, the government will subsidize miners 20 cents per pound, but at prices of 85 cents per pound, the government's fund will receive only 2 cents per pound back from the cooperatives. Despite the government's claims that the fund will be "sustainable" and is not a handout, we doubt that the fund will survive without additional flows of government funding.

¶7. (SBU) This type of government support for the cooperative mining sector--the most dangerous and environmentally damaging industrial activity in Bolivia--also provides a perverse incentive to keep the cooperative mines at higher production than the market warrants. Despite these drawbacks, the government has announced its intention to create other funds for other minerals. In light of the potential impact of the world economic downturn on other industries, the government may find itself questioned as to why miners deserve a fund when textile workers are losing their jobs (the obvious answer that 'textile workers are less likely to throw dynamite', while true, may not be politically expedient.)

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Keeping State Miners...on the Payroll
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¶8. (SBU) During the boom times of the last few years, the government completed its nationalization of the Huanuni tin mining complex and expropriated Glencore's Vinto smelter. True to populist instincts, the government increased staffing from 800 to 4000 workers, a manageable situation when tin prices were at USD 11 per pound but unsustainable at current prices less than half that. Even if the miners' contracts allowed the government to fire them, the government is unlikely to want over a thousand unemployed and enraged miners to descend upon the city of La Paz. In October 2006, fighting between cooperative and state miners in the Huanuni complex left 16 dead and over 60 wounded, and both sides blamed the government. In July 2007, miners from Huanuni threatened to "take" the city of La Paz and were only turned back when the government made significant concessions, including releasing miners who had been arrested bringing explosives into the city.

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Small Mines, Big Needs
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¶9. (SBU) The president of the national chamber of small mines, Ramiro Aguilar, announced on October 29 that small mines employing roughly three thousand miners have closed due to the drop in minerals prices. Aguilar claimed that the government is considering a credit fund (such as that described above for cooperatives) to help the sector: reportedly the government is considering a fund of USD 1 million while Aguilar claims that the sector needs at least USD 3 million. Small mines have also suffered recently from a spate of "mine takings", in which local communities have taken over mines, sometimes resulting in deaths and always resulting in financial losses. The government, through the Ministry of Mines, has been unable to effectively address this challenge to property rights, and some small miners have told us that their only option is to either cede some control to the local communities or to encourage their miners to "fight back."

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Misery Loves Company
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¶10. (SBU) The miners' problems (whether cooperativist or private) have had predictable follow-on effects for other links in the minerals-production chain. The association of Potosi refineries reports that half of their members have stopped work, and many of those have been forced to let employees go. Although the relatively-higher prices of silver and tin have allowed some mixed-metal refineries to continue to work, the dramatic drop in the price of zinc has hit the industry hard, and a member of the association noted bitterly that "Unfortunately, unlike our brother miners, we do not receive any assistance from the government." Minerals trading companies are also closing; many of the victims are young companies that opened during the boom and were not positioned to survive a bust. The Bolivian blame game has also begun, with some miners "denouncing" traders for setting low prices. (Note: Not only the mining industry is affected. In mining towns in Potosi and Oruro, almost all commerce is dependent on mining incomes, and the sinking tide has lowered all boats. Taxi companies, restaurants, and other service providers are also closing. End note.)

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Taxing--and Otherwise Ignoring--International Mines
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¶11. (C) The government has announced no initiatives to help large private mines in Bolivia, nor are any expected. Despite repeated assurances to Apex's San Cristobal that the additional 25 percent surtax (which only San Cristobal pays) will be eliminated, there seems to have been no government progress on this legislation. Bolivia's effective tax rate on

private mining is one of the highest--if not the highest--in the region, and political turmoil is deterring additional investment. One U.S. investor has recently informed us that their project is on "indefinite hold", and international companies in Bolivia are worried about the effects of the draft MAS constitution, which if it passes will eliminate the possibility of international arbitration or diplomatic claims.

¶12. (SBU) Although the government is still proudly touting its agreements with international companies Jindal (India) and Kores (South Korea), the reality is very different from the political propaganda. While the government hypes "total investment" figures, Kores's project at the CoroCoro copper deposit and Jindal's at the Mutun iron deposit are in fact still in early stages of exploration, and both contracts allow the companies to back out if the deposit does not look profitable. Sources close to the Jindal project tell us that the government is not fulfilling its contractual promises to create transportation routes and improve infrastructure. Some industry analysts suggest that Jindal may be contemplating a quick extraction of the enriched top level of the deposit, followed by breaking the long-term contract because the government has not lived up to its part of the deal. If this happens, the government will lose its hoped-for investment in steel manufacturing, since Jindal would instead ship mineral concentrate (the government currently does not have enough natural gas to sell to Jindal--at a subsidized rate set in the mining contract--for Jindal to be able to invest in the steel-making or powerplant originally envisioned for the project.)

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Comment
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¶13. (C) The Morales administration's heavy-handed involvement in the economy is crippling investment in natural resources at a time when an international boom should have enriched Bolivia's coffers. Having pushed for state investment in the sector, the Bolivian government is now doubly hit by the downturn in prices, both as a taxing entity and as an owner. Effectively buying allies, Evo cannot risk a massive wave of unemployment in the ranks of either cooperatives or state miners, and must instead insert the government deeper into these sectors. How the government will finance these proposed funds in the face of declining tax revenues and royalties is an unanswered question. Despite the fact that private mining (with international investment) is responsible for over half the growth in GDP this year, the government is doing nothing to help international investors, since they are unlikely to protest for or against Evo (with dynamite or without.)
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